IB Business and Management

Question Bank

Case Studies

VIDLER

Vidler, a supermarket in the tertiary sector, is preparing to announce job cuts among its top management in an attempt to remove a level from its organisational structure and reduce the bureaucracy in its head office.

Bill Adriano, Vidler’s Chief Executive, has ordered 600 job cuts at the New York and Chicago headquarters including 80 senior executives, in a move to reduce head office staff by 10%, modernise the management structure and save the company an estimated $30 million a year. None of the positions will be replaced and the proposed change is seen by shareholders as an attempt to cut costs, in an extremely tough trading environment. The last round of job cuts were made in 1994 when 650 jobs were lost, but on this occasion senior management and top executives were not affected.

Bill Adriano is responding to shareholder pressure to take whatever action is necessary to improve trading performance. Vidler’s has lost market share to Vercher, its main competitor, and needs to improve performance and regain customers in order to re-establish itself as the market leader.

Figure I Market Share information

	1999 %	**1998** %
Vidler	26	30
Vercher	28	25
Valuemart	6	6
Vintners	16	15
Other	24	24

Vidler completed an expensive TV advertising campaign in January 2000 which generated only a small increase in sales. Sales at Vercher rose by 4%, compared with 1.2% at Vidler’s.

At an annual shareholders’ meeting Bill Adriano reported the following financial information

Figure II

	1999 $	2000 (projected) $
Total sales	2 600 000	2 400 000
Total cost of sales	1 820 000	1 900 000
Administration costs	140 000	145 000
Selling and distribution costs	40 000	42 000
Other costs	80 000	81 000

Vidler’s appointed a market research consultant, to undertake a $10 million project to find out the perception consumers had of Vidler, compared to its rival, Vercher.

Figure III Main Findings of the Project

Vidler	Vercher

Dull grey and brown corporate identity	Bright modern corporate identity
Few special offers	Special offers to attract customers
Slow checkout services	Fast scanning to speed up checkout
Telephone order line	Internet ordering
Narrow aisles	Wide aisles
Staff discount	Staff bonus scheme for suggestions
Standard trolleys	Different trolleys
Small car parks	Large car parks

<u>FUN AIR</u>

In 1995, Jeff Martin decided to set up his own airline, having worked for twenty years as a marketing executive of a holiday company. His research on the airline market showed six international airlines controlling 96% of all air traffic to destinations in Northern Africa. This market segment was worth nearly $1.2 billion per annum. Market data for 1997 is shown in ***Table 1***.

Jeff Martin was surprised that most airlines offering charter fights (where blocks of seats are purchased by holiday companies) gave discounts as little as 5% over scheduled (standard) flight prices. None appeared to focus on the family segment. Jeff Martin recognised a potential market niche and ‘Fun Air’ was born

Jeff Martin purchased three second-hand 200 seat aircraft, and in January 1999 began serving three routes offering the highest profit margins. He runs one return flight per day to each destination, 365 days a year. In the event of an aircraft breakdown he has an arrangement with Eagle Air, costing $2 million per year, to carry his stranded passengers. This has proved good value. Fun Air suffered reliability problems throughout 1999, resulting in planes being grounded for an equivalent of 26 days.

Marketing Mix

The Product

Fun Air targets families with school age children. At check in, children are offered games and activities run by ground staff, which helps reduce parental stress. Aircraft are fitted with personal entertainment consoles, including video and music channels and computer games. Children can visit the flightdeck, and games and quizzes are offered throughout the journey.

The service can be described as ‘no frills’. Food and drink is basic and provided by a burger company, which serves the same food as it does in its restaurants. This joint venture is beneficial to both companies. The burger company sells many additional meals and in return distributes advertising leaflets for Fun Air in their restaurants. Above all, the meals cost Fun Air little and the kids love them.

Promotion

Apart from leaflets in the burger restaurants, Jeff Martin negotiated another joint venture with two popular newspapers. He provides free tickets on Fun Air for the months when demand for seats is low. The cost of these is included in promotion expenses. In return, the newspapers run competitions and voucher schemes using these tickets as prizes. No other advertising is conducted, but Jeff Martin takes every opportunity to identify public relations opportunities. He frequently organises children’s parties, often for disabled groups. On one memorable occasion he arranged a record-breaking juggling marathon for children, which attracted national attention. Fun Air is also a contributor to several children’s charities.

Pricing

Prices are set at a very competitive fixed price of $300 for a return flight which applies to both children and parents. No discounting is allowed except in the months of February, March, October and November when a non-bookable walk-on service is offered to passengers at 40% discount.

Ticket Sales

These are made direct to customers through postal applications included in newspaper advertisements and burger restaurant leaflets. Alternatively customers can book by telephone, or through an Internet website. Tickets are not distributed through travel agents, which ensures all profits remain with Fun Air.

Personnel and Administration

Jeff Martin keeps overheads down to a minimum. Fun Air operates from a converted airfield building. All employees are called partners and have shares in the business. Jeff Martin is on first name terms with all his employees. Administrative staff are few and the organization structure is very flat. The organization chart is shown in ***Table 4***.

Partners have to be flexible and prepared to undertake several roles when the need arises. All partners have either experience of the leisure industry or have worked with children. Fun Air operates a 'Like Us' scheme, where existing partners are paid bonuses for introducing 'similar friends' to the organization. This is so successful that virtually all recruitment happens this way.

Finance

Jeff Martin borrowed heavily to buy his first three aircraft using finance from a venture capital company which took a 5% shareholding in return. At the end of 1999, Jeff Martin prepared financial and sales data shown in ***Tables 2*** and ***3***.

The Future

By the end of 1999, Fun Air captured a 15% market share. Jeff Martin intends to lease two newer aircraft. Competitors have started to take notice. Eagle Air has given notice of cancellation of its support contract. Free Spirit has announced that it is starting up its own budget operation, 'Flyway', in direct competition. Omega Air and Air Gazelle are rumoured to be cutting prices on Fun Air's routes after 'informal' discussions and are in merger talks.

The growth in the European economies has slowed and tourist experts are predicting a 2% reduction in air travel over the next two years. It is not clear what effect this will have on budget operators like Fun Air.

Table 1 Market data for 1997

Airline	Formed	Market Share	Pricing	Asset size	Core customer
					$
Free Spirit	1934	40%	premium	4.0 billion	international business
Eagle Air	1937	24%	premium	2.8 billion	international business
Air Gazelle	1972	16%	average	850 million	tourist/budget
Omega Air	1983	9%	average	470 million	tourist/charter
Neal Air	1990	4%	average/low	140 million	tourist/charter
Morcair	1972	%	low	110 million	charter/domestic

Table 2 Monthly ticket sales 1999 (full price return journey)

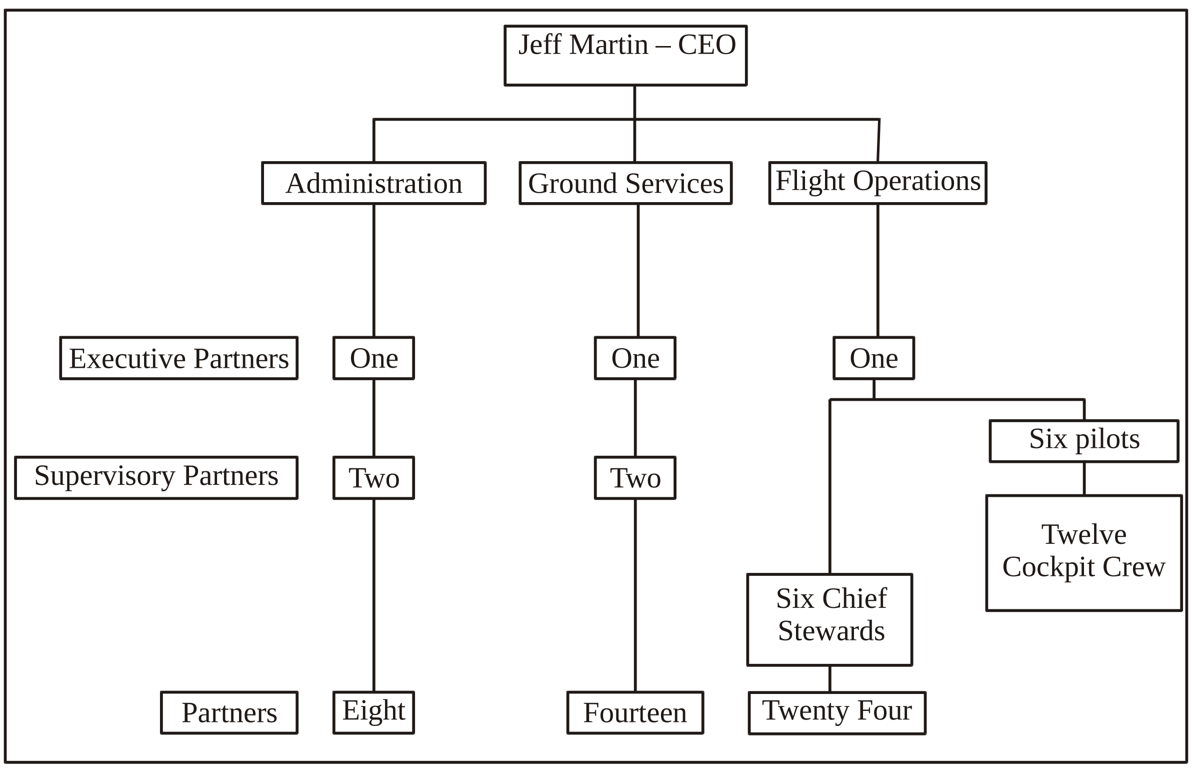
J	F	M	A	M	J	J	A	S	O	N	D
12500	8000	10400	13000	15000	17400	17800	17750	17350	12000	10000	18000

	Feb	March	Oct	Nov
Discounted ticket sales				
Walk-on sales	1500	2000	1800	1500

Table 3 Cost structure

		$
Variable costs: (per **passenger** for a return flight)	labour	12
	landing charges	8
	food and drink	7
	miscellaneous costs	3
Annual Overheads:		**$000**
	fuel and maintenance	6250
	salaries and bonuses	2270
	administration expenses	1500
	rent	500
	promotion expenses	300
	ground service fees	3400
	Eagle Air support	2000
	insurance	2800
	Internet/communication fees	1250
	aircraft depreciation	20000

Table 4 Fun Air – Organisational Chart



<u>OPEN VIEWS, WARM BREEZES AND CLIENT DELIGHT</u>

Background

Joseph Obeng is the founder of an independent travel business called *Open Views*. *Open Views* is a private limited company operating out of four small city-centre premises, but selling most of its holidays through mailed brochures. Joseph has been the Managing Director and Chief Executive Officer of *Open Views* for fifteen years. *Open Views* specialises in individualized, adventure holidays to luxurious resorts and targets the "discerning customer". Joseph defines these customers as individuals with high disposable income, looking for holidays to unspoilt resorts with an exclusive image, and who are seeking the "unusual" *(see appendix I)*. Joseph prefers to describe customers as "clients" and believes he offers a unique and individualized service. He aims to provide additional optional services with a high value added. These can include trekking, climbing, scuba diving and shark fishing. For an additional fee, mini-cruises in a traditional sailboat can be arranged. Joseph also offers a "bespoke" service where he visits clients in their homes to put together a specific programme to meet their individual needs. Several celebrities have used this service.

Competition

Joseph's success in the exclusive tourist niche has attracted the attention of other holiday operators. Two multinational organizations, *McGregor's* and *Blue Sea*, now offer a specialist service for the luxury end of the market. As yet, they have not developed the individualized approach operated by Joseph. However, he is well aware that they are attracting some of his target market. There are many other smaller specialist holiday operators, which offer similar approaches, but they tend to be regionalized and as yet offer no particular threat to *Open Views*. Joseph knows that markets are dynamic and competition can only increase. He constantly reviews potential ways of expanding his business to create greater economies of scale and to offer a more varied experience for his clients. He has examined the possibility of going public, but is concerned about the potential for take-over.

He believes that the way forward is through organic growth linked to strategic alliances and joint ventures. He wants to keep a tight rein on his business, having seen several of his rivals lose financial and operating control as their businesses grew. As a result, Joseph has become slightly obsessive about cost control in the business.

Developments

In pursuit of his desire to expand his business, Joseph frequently visits the Caribbean to explore smaller islands, which might offer new travel opportunities for his brochure. Six years ago, he met the Daswami family, who own a chain of small and medium hotels and village resorts in the Caribbean. The family are very entrepreneurial and result-orientated and their businesses in the region have expanded rapidly.

The hotels and resorts are situated in established towns and are linked to many local businesses, several of which are owned by family and friends. The eldest daughter, Manjit Daswami, runs the financial side of the business, and Joseph and Manjit had quickly built up an excellent working relationship. For the last five holiday seasons, *Open Views* has used the Daswami hotels and resorts. All *Open Views*' customers are asked to complete a satisfaction survey at the conclusion of their holiday, but there is only a 40% response rate. These

completed questionnaires show very high satisfaction ratings *(see appendix 2).* In particular, customers say they appreciate the personal service and the sense of being part of the local community. The excellent, local fresh food is also praised.

In January 1998, Joseph had suggested to Manjit that they form a joint venture to exploit a niche in the market for a centre-based, inclusive package holiday. The concept was to target couples looking for a luxurious, all-inclusive holiday in a romantic setting. Couples would pay one fee to include all food, entertainment and use of facilities. After researching several possible locations for their holiday resort, Joseph and Manjit built a holiday complex called *Warm Breezes* on an unspoilt island. The local government, concerned about high unemployment rates, provided financial support.

Warm Breezes opened in January 1999. Holidays at the complex are sold exclusively through *Open Views* brochures. The resort boasts beautiful palm-fringed beaches and a coral reef, which is home to many exotic and rare fish. The hotel complex offers everything couples could want on site. A fitness centre and a spa pool sit alongside tennis courts and three swimming pools. There is even a nine-hole golf course and putting green. If holidaying couples want a change of scenery, hotel ferry boats run day trips from the hotel jetty to local deserted islands for sunbathing or for fishing.

A recently introduced specialist service is to arrange weddings for couples, which are held below a secluded waterfall on the island, and offer them a “newlywed” five star package including beach party, bridal suite, flowers and midnight cruise. This proved very popular with customers in the first season, and with Manjit and Joseph who are able to charge a premium price.

Marketing

Marketing of *Open Views* holidays is minimal. Half of all bookings are repeat bookings from existing, satisfied customers. Word of mouth recommendation is very powerful and customers are offered a 5% discount on holiday prices if they introduce friends who subsequently book with *Open Views.*

Advertisements for *Open Views* are taken out in several specialist travel magazines and in the business press. However, the majority of holiday bookings are stimulated from the *Open Views* brochure, which is available in *Open Views* shops and by mail order. The brochure is glossy and expensive to print and Joseph wants to minimise wastage. Last year he hired a direct marketing consultancy to coordinate mail drops focused on specific postal (zip) codes where affluent, potential customers are known to live. This campaign generated a substantial increase in new customers, and appeared to pay for itself.

When asked what sells *Open Views* holidays to clients, Joseph always says the quality of the experience. The introduction to the *Open Views* brochure states that the firm provides “a total sensory experience to provide client delight”. Several customers have said that they really do not know what this means. Joseph would like to develop a mission statement and a suitable logo to unify his products and provide a superior market identity.

Human Resources

Open Views employs thirty-four staff in its head office in a sales or administrative capacity. Joseph is now spending approximately four months, in any one year, overseas. Colleagues

who know him well can see signs of stress caused by his heavy workload, but he is unwilling to let go of major decisions or strategic planning. Communication throughout the company is poor and tends to be “top-down”. Most information handling is via the telephone. When Joseph is in the head office, he has a very “hands-on” leadership style and visits all of his shops weekly and is always eager to praise his staff and offer advice. The employees generally like his personal approach, but as the business grows they are finding Joseph’s visits rather disruptive. He tends to make decisions without all the information and then leaves experienced employees to cope when things go wrong. Two years ago he appointed an operations manager, Marc Leroux, to oversee the business when he is abroad, and to set a strategic direction for the business. Marc is a personal friend and invested capital in *Open Views* in return for a 20% shareholding. Although Marc has an excellent financial background, the staff feel he lacks a true understanding of the holiday business and concentrates too much on cost control, and sales and profit targets. These targets are very testing and demand year-on-year growth of approximately 10%. Salaries and bonuses are linked tightly to these targets. Over the last two years as competition has increased *Open Views* has been forced to cut profit margins to gain new business, and as a result salaries have not kept pace with average earnings in the industry. Concern is also being expressed about the slowdown of the United States and European economies, which is likely to affect the business adversely. Staff have become anxious and are considering approaching a trade union to represent their interests. Several employees have already visited the local branch of the ATS (Association of Travel Staff), the trade union representing employees in the travel industry.

Joseph delegates all staffing activities in the *Warm Breezes* complex to Manjit. She appointed a general manager, Peter Storm, who had previously worked for the rival travel company, *McGregor’s*. Peter is an autocratic manager and local staff find him unapproachable and patronising. He brought in a team of Europeans and appointed them to senior positions. Staff turnover is high and this often threatens to disrupt services. There have also been complaints about the safety of the working environment and the state of repair of cleaning and cooking equipment.

However, unemployment in the region is still significant and Peter has coped to date by using a local employment agency and casual staff. Casual staff are generally foreign students visiting the Caribbean and looking to finance their trips. The business is successful and net profits are good *(see appendix 3)*. Customers mostly leave satisfied and Manjit believes Peter is doing a very good job. However, complaints about slow service and rude staff have increased over the last few months.

The Future

Hotel room occupancy at *Warm Breezes* fluctuates throughout the year, with the complex being fully booked from April to September *(see appendix 4)*. There is concern because occupancy falls to 40% in the wetter, colder months of the Caribbean year, but at other times customers are turned away. Manjit and Joseph are exploring opportunities to extend the *Warm Breezes* complex further and to raise occupancy levels during the quieter months.

There are two options under consideration.

Option 1
To develop a commercial centre adjacent to the main buildings, containing sales and conference facilities. These would be marketed to multinational organizations for staff training and motivation development. Manjit would like to create a “team-building” theme. There is a disused army training camp on the island, where the United States army used to

practise jungle warfare. The old assault course could be easily restored and Manjit has even suggested to Joseph that they could create the world's most exclusive war game development. Joseph is not sure that this approach fits their image.

Option 2

To extend the complex by building forty new cottages alongside the beach front. These would offer self-catering accomodation. *Open Views* would need to target a different market segment, and again Joseph has some concerns about this option. Manjit is confident that this development would not compromise the luxurious image of the complex.

Both schemes will require the raising of additional finance to fund construction. Joseph and Manjit hope to persuade the local government to provide 50% of the funds to be matched by a loan from an international bank. In return they are intending to employ an additional sixty-five local staff while offering a 20% minority shareholding to the bank. They are anxious to highlight the positive effects on the local economy boosted by the building works and extra full-time jobs.

However, the local government has recently changed and has different views to the one which gave permission for the original *Warm Breezes* development. It was elected amid concerns about the environmental effects of further tourist and business development and has received several complaints from local businesses about the impact of *Warm Breezes* on the local economy. Government officials are insisting that representatives of the local trade unions and small business associations be involved in any future negotiations. The government have already presented Manjit and Joseph with written details of some of the objections to their present operations and proposed expansion. These are summarised below.

- 70% of the existing staff of *Warm Breezes* are locally recruited, but no senior managers come from the local community.

- Nightly entertainment is essentially brought in from the United States and Europe and local bands are rarely employed. When local bands and dancers are employed, the music and dancing is westernized to satisfy European and North American tastes.

- The "all-inclusive" package offered to holidaymakers restricts the use of the local restaurants and other services. Visitors to *Warm Breezes* frequently leave the island without coming into contact with the local population, or experiencing their culture.

- Staff are required to wear uniforms, which include designs from the Caribbean, but are not purchased locally despite using authentic island patterns. In fact, these uniforms are designed and manufactured by an Italian fashion house.

- The proposed new development will require the felling of twenty palms and the dredging of the shore to allow the mooring of boats, which would threaten the ecology of the reef.

- Most of *Warm Breezes'* profits go overseas and not into the local economy.

Manjit is concerned about these criticisms, but is convinced that her family's local connections will help promote their case to the government and unions. She suggests that they will have to develop detailed ethical and environmental guidelines for *Warm Breezes* to convince their opponents that the expansion is in the economic and social interests of the

island and its population. Local businesses appear to favour the commercial centre over the cottages, as this will create more jobs. If all else fails, Manjit is already in discussions about a second *Warm Breezes* holiday complex, with the government of a neighbouring island, which appears to be more favourable to tourist development and is encouraging inward investment by offering tax breaks and subsidies.

APPENDICES

Appendix 1: Open Views target customer profile

Age 24 to 36

Net income	Single	Couples
	$	$
	60 000 - 150 000	80 000 - 250 000

Social grouping	Upper middle class home owners – senior managerial, administrative and professional occupations. Over 50% working in financial and service sectors.
Family life cycle	Bachelor stage and newly married couples with no children.
Location	Europe, Middle East and the United States plus Southern African countries.
Psychographics	Adventurous, risk-taking, fashionable, image conscious, early adopters, conspicuous consumers.

Appendix 2: *Open Views*' customer satisfaction research: 2001 (2000 in brackets)

	Excellent %	*Good* %	*Satisfactory* %	*Poor* %	*Very poor* %
Service					
• When booking	40 (42)	45 (46)	6(10)	7(2)	2 (0)
• At the resort	46 (55)	34 (37)	8(4)	10(2)	2 (2)
Accommodation	65 (62)	20 (20)	8(9)	4(5)	3 (4)
Local environment	54 (55)	38 (39)	6(4)	2 (2)	0 (0)
Entertainment	42 (45)	30 (29)	14(10)	8(10)	6(6)
Food	40 (50)	30 (38)	15(4)	8(4)	7(4)
Leisure facilities	58 (55)	32 (36)	8 (4)	2 (5)	0 (0)
Entire package					
• Value for money	42 (50)	48 (46)	6 (4)	2 (0)	2 (0)
• Quality experience	46 (54)	36 (36)	8 (6)	6 (2)	4 (2)
• Optional activities	50 (48)	38 (36)	8 (8)	4 (4)	0 (4)

Comparison with expectations

Exceeded %	*Met* %	*Fell short* %
40(46)	50(52)	10(2)

Appendix 3: *Open Views* - Summary Profit and Loss Accounts and Balance Sheets: 1999-2001

Profit and Loss and Trading Account for the years ending 31 December:

	1999	***2000***	***2001***

	$m	$m	$m
Sales revenue	28.6	34.5	40.2
less			
cost of goods sold	3.8	4.9	6.1
Gross profit	24.8	29.6	34.1
less			
overheads	21.2	25.8	30.6
Net profit	3.6	3.8	3.5

Balance Sheet as at 31 December:

	1999		2000		2001	
	$m	$m	$m	$m	$m	$m
Fixed assets		42.8		43.4		46.6
Plus						
Current assets	3.4		3.8		4.1	
less						
Current liabilities	2.1		2.5		2.9	
Net current assets		1.3		1.3		1.2
Total/net assets employed		44.1		44.7		47.8
Represented by:						
Share capital		24.0		30.0		30.0
Reserves		6.4		6.6		7.0
Long-term liabilities		13.7		8.1		10.8
Total capital employed		44.1		44.7		47.8

Appendix 4: *Warm Breezes* occupancy rates

	Jan	Feb	Mar	Apr	May	June	July	Aug	Sept	Oct	Nov	Dec
	%	%	%	%	%	%	%	%	%	%	%	%
Year:												
1999	44	42	63	100	100	100	100	100	100	65	42	48
2000	45	45	65	100	100	100	100	100	100	66	43	48
2001	43	44	63	100	100	100	100	100	100	62	40	46

RAINBOW CLUB LTD

Rainbow Club Ltd runs four senior and three junior ice hockey sides, with both male and female teams. The men's first team, the *Rainbow Raiders*, competes in the national premier league and won the national title in 2001.

Rainbow Club Ltd operates out of a community centre which is open to the general public and has an ice rink and a ski slope. The centre is owned by the local government and *Rainbow Club Ltd* rents the ice rink from them for all their ice hockey games and pays a contribution towards the maintenance of the rink. Finance for the operation of the ice hockey teams comes from ticket sales, sales of merchandise such as team kit and hockey equipment and from sponsorship and advertising. The only fixed assets owned by *Rainbow Club Ltd* are a club shop next to the centre and a fleet of cars purchased for the players and senior management.

Personnel

Rainbow Club Ltd was established in 1986 by the Swale family, several of whom played ice hockey to an international standard. All the family members agreed that the teams should be truly international. The present chief executive officer and chairman, Joe Swale, is the major shareholder, with a 60% stake. His brother, George and his sister, Nancy, own the remaining shares. George runs the administration of *Rainbow Club Ltd*, including the human resource function. He has no particular training in these areas but has acquired considerable experience over the last ten years since he joined the club. Nancy, who has a management degree, is in charge of corporate communications, merchandising and marketing. The organization structure of the club is shown in ***table 1***.

Both George and Nancy are popular with the employees and players and take an active role in the day-to-day operations of the club. Nancy frequently visits local schools and children's homes and her work with disabled groups has been promoted through clever public relations and praised in the local press. Recently, *Rainbow Club Ltd* sponsored a disabled team, which competed successfully in the National Athletics Championships, and the trophies won are displayed in the club's reception area.

Joe Swale recently appointed a long time friend, Robert Graves, to oversee the financial side of the business. Robert has a background in sports finance and corporate sponsorship and is working to secure longer-term contracts with companies boasting international sporting reputations. Robert is highly respected as a "financial fixer", but even he is worried about the present financial position of the club.

Joe Swale runs the club like a personal possession. Popular with club supporters, who respect his passion for the game, Joe is credited with responsibility for the club's successes. He is highly charismatic[1] and exudes charm in public. He makes sure he attends all games and always invites carefully selected club supporters into the director's bar during the intervals. In fact, Joe spends little time in the club dealing with policy and overall administration as he has many other business commitments not related to ice hockey. His visits are becoming increasingly infrequent and are often fast and furious. He treats with contempt those staff and players who he believes are not committed to the club and has been known to bring even the strongest of players close to tears. Joe fails to recognize that publicly disciplining players is insensitive. George Swale, who believes more in employee participation, attempts to calm those who have been upset, but with limited success.

Administrative staff are paid only about 80% of the salaries earned by employees of similar clubs. As a consequence there is high staff turnover (nearly 30% last year) and low morale. Players' salaries, however, are in line with national averages. Many players respect Joe's approach and his

passion and knowledge of the game has attracted key players to join the club in the past.

Joe’s long-term vision is to develop *Rainbow Club Ltd* into a major international commercial enterprise to enable the *Rainbow Raiders* to compete on the world stage and to compete with their greatest rivals, the locally based *Jets.* He sees this as a matter of personal reputation and a source of pride for the supporters. The *Jets* have always been the larger of the two local clubs with more resources to attract the best foreign players. In support of his vision to make the *Rainbow Raiders* a major international enterprise, Joe is in negotiations with a multinational media corporation. They are planning to show *Rainbow Raiders*’ games across the globe on satellite and via the Internet. This should generate significant merchandising and marketing opportunities.

---

[1] charismatic: inspiring leader

The playing side

The *Rainbow Raiders*’ chief coach is Dan Carderelli. He set up an extensive scouting system for new talent when he joined the club in 1997. Of the present senior *Rainbow Raiders* squad, twelve come from different countries, satisfying Joe’s desire for a truly global squad. Of the remaining squad members, seven came up through the junior ranks. The present team captain, Brad Mansoff, represented his country at both under 14 and under 16 levels and is now a senior international.

Last season (2001-2002) the *Rainbow Raiders* dominated the premier league, leaving the *Jets* languishing ten points behind them. The *Rainbow Raiders* have in fact won the league four times in the last six years. However, everything is far from perfect this season. They have played all but three of their scheduled league games and lie near the bottom of the league table. The *Jets* are holding onto the top spot. Dan Carderelli does not feel very secure in his job, knowing that Joe sacked three coaches in quick succession after the team performed poorly in the early 1990s.

The *Rainbow Raiders*’ players seem to lack motivation. Perhaps, as a consequence of this and a lack of dedication in training, several players are receiving treatment for injuries. Joe believes that Brad Mansoff has been spending too much time undertaking promotional activities and not enough time training. He has threatened to sell Brad to another club unless he returns next season, fitter and more focused on winning.

Recently, Dan Carderelli has had several very public rows with Joe Swale, who has begun to interfere in the selection of teams and bought and sold players against Dan’s advice. New additions to the team include three overseas players. Dan is concerned that they have been bought more for the merchandising opportunities they bring to the club, than for the talent they contribute to the team. Joe always maintains that the club is a business and that he has to be sensitive to its financial position.

Financial matters

In addition to problems on the ice, the club has recently been running at a weekly loss, which is creating significant cash flow problems. The major club sponsor had been *The New Dominion Bank,* but it withdrew its sponsorship at the end of November 2002. It is now near the end of May 2003 and the current season finishes soon and the new season does not begin until the middle of July. Negotiations with a possible new sponsor *DQ Sports Inc,* a multinational sportswear and equipment company, are well advanced. However, contracts have not been signed and several suppliers of equipment have outstanding invoices and are threatening legal action. A cash flow statement for the past six months of operations is shown in ***table 2***. It illustrates the problems *Rainbow Club Ltd* is presently suffering. There will be no ticket and merchandising revenues during

the six-week off-season break (June–July 2003) but most of the club's overheads will continue at their present levels. The summary trading, profit and loss account and summary balance sheet for *Rainbow Club Ltd* is shown in ***table 4***, It is believed that merchandise revenues will increase significantly once the *Rainbow Raiders* link up with *DQ Sports Inc*, which own many domestic and international retail outlets. The mark-up on replica shirts is already over 300% on cost and expected to rise, given the purchasing power of *DQ Sports Inc.*

As a result of poor liquidity, the players and coaching staff have not been paid for May, causing unrest and anger in the team. There are rumours that some senior players and their agents have been in discussions with other ice hockey teams, including the *Jets*, regarding possible transfers.

The players are members of PACKICE, the trade union for professional ice hockey players. Following several meetings between *Rainbow Club Ltd* officials, the union and senior players, the players have agreed that they will wait for three months for payment, whilst the club attempts to sort out its cash flow problems. After this period the players are threatening to strike if the issue is not resolved.

The facilities and ticketing

The ice rink itself is showing signs of wear and tear and is in need of significant renovation. Its seating capacity of 3500 is well below the league average of 8000 spectators and it is close to full for every game. As a result Robert Graves believes that ticket prices for the better seats should be increased, as demand for the seats is relatively price inelastic. A few hundred seats have a restricted view, and it is these which often remain unsold despite a discounted price. Ticket sales for the past six months are shown in ***table 3***.

Ticket prices for games vary from $30 to $80 according to the seating position. These prices compare favourably with the league average of $40 to $100 and particularly well with the *Jets*' prices of $45 to $120. However, the seating at the *Jets*' stadium is superior, as are all their facilities. The *Jets* even have conference rooms for corporate entertainment. The *Rainbow Raiders* only have four corporate boxes where sponsors and their guests can sit. For these, the sponsors pay an additional annual fee. On average the seats in these boxes make a profit of $130 per person per game.

The *Rainbow Raiders* have an extremely loyal core of supporters, estimated at 4500, who attend more than ten games per season. It is believed that there are another 4000 spectators who might be persuaded to buy tickets for *Rainbow Raiders*' games. At present, they are put off by the facilities at the ice rink and the difficulty of obtaining the better seats.

Without a major sponsor, there are lower revenues from the corporate boxes as well as reduced finances available for running the team. The revenue generated from selling seats and merchandise is insufficient to cover the club's running costs, and this is at the root of the present liquidity problems. *The New Dominion Bank* is currently guaranteeing the firm's overdraft, but has informed the club that it will expect this to be repaid by December 2003.

Medium-term options

Joe Swale, Robert Graves, the board of *DQ Sports Inc* and the local government recently met to discuss the *Rainbow Club Ltd*'s options. Two possible plans are under review:

Option A

The redevelopment of the community centre. This would involve acquiring adjacent land to build a larger rink, with seating for 10 000 spectators and the construction of several retail

units and a cinema complex. This might be possible as there is a derelict industrial site next to the ground. Extended car parking facilities are available at a nearby hotel, which is prepared to consider a joint venture with the *Rainbow Club Ltd.* The major drawback of this option is increased traffic congestion, which is already causing problems in the nearby town centre. It would also result in the loss of the artificial ski slope, as the area would be required for the retail units. Naturally the local government has concerns about this option.

Option B

Move the whole ice hockey club to the village of Carlton, a new site thirty kilometres to the south in a rural setting, but alongside an existing motorway. This would involve a merger with a local lower division ice hockey club. It is the preferred option of Joe Swale, as it would allow the construction of a larger purpose-built entertainment and leisure centre with extensive car parking facilities and future expansion opportunities. It is also popular with two further potential club sponsors who see the opportunity for developing their corporate hospitality interests. However, there is concern that existing loyal fans may not be prepared to travel the extra distance and may switch support to the local rivals, the *Jets.*

Recent market research carried out by the marketing organization *Target Data,* commissioned by Joe Swale, examined demographic profiles and trends in the area around the community centre. They found that the local population was ageing as younger people moved to the cities for employment. However, if the club were to move to Carlton, the proximity to the motorway would allow the club to attract a whole new set of fans from the regional capital who are younger, with considerably higher disposable income. *Target Data* also criticized the club for its existing confused marketing messages and recommended that Nancy Swale should identify more precisely the *Rainbow Raiders'* target market to allow for more cost-effective promotional activities.

News that the club might be moving away from the area has leaked out and opposition to the possible move is growing. The editor of the club's team fan magazine, *The Roar,* has written a critical report about Joe Swale for the next edition under the title, "Betrayed". Several hundred fans are planning to demonstrate against the proposed move after the next ice hockey game. Some local firms, such as hotels, travel companies and bars, have expressed concern that they will lose business opportunities and are seeking a meeting with the club. It is also believed that local environmental groups will oppose the move to Carlton as several species of rare insects have been found in the area.

Both options under consideration for expansion will require considerable extra finance. The advantages of further development are the higher potential revenues and economies of scale in the operation of the business, plus the possible realization of Joe's vision for the club.

The main issue is how the club will survive in the short-term.

Table 1:

Organization structure of *Rainbow Club Ltd*

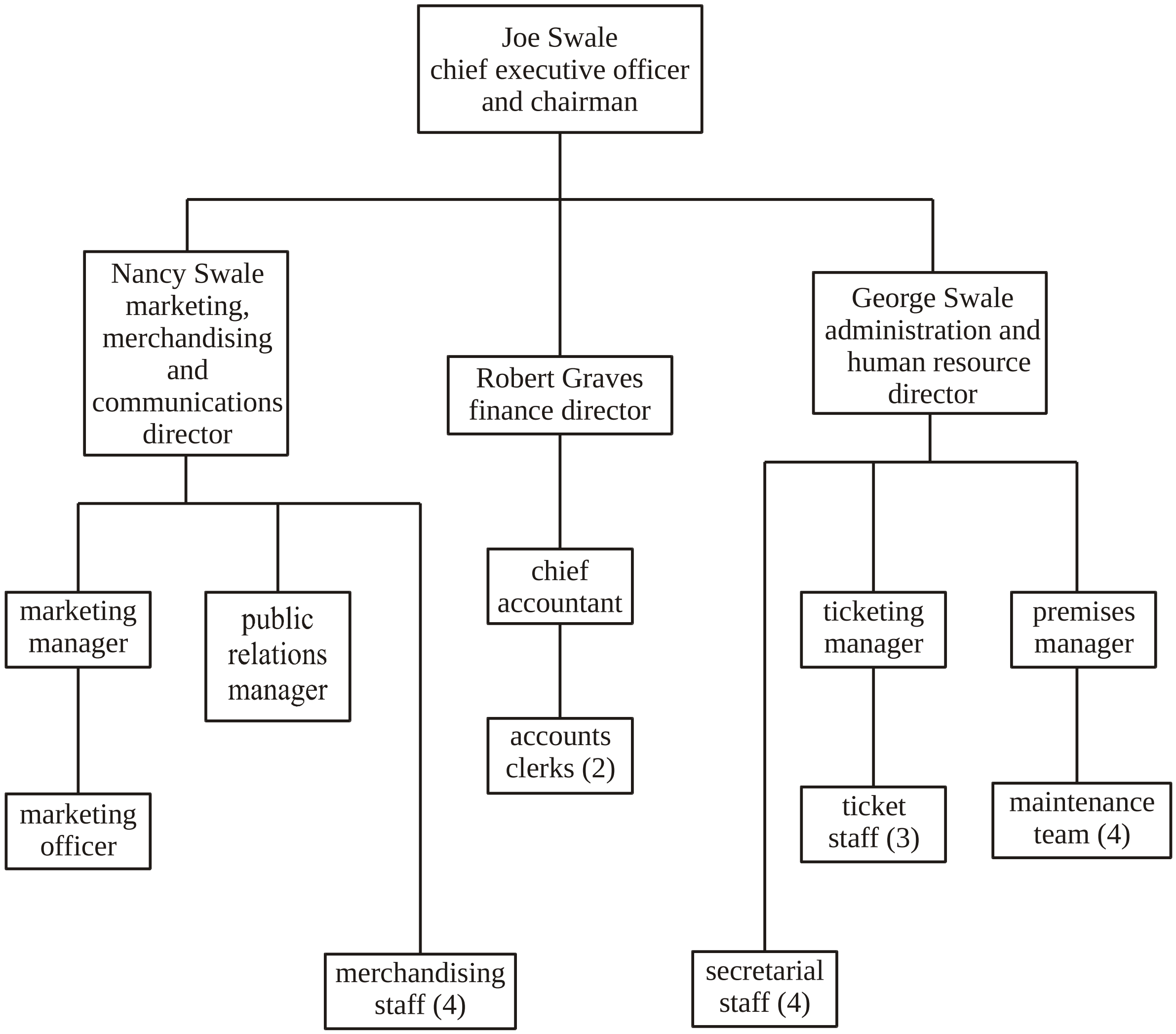


Table 2:

Cash Flow statement for Rainbow Club Ltd for the last six months, November 2002 to April 2003

$000s

	Nov	**Dec**	**Jan**	**Feb**	**Mar**	**Apr**
Receipts						
Ticket sales	560	600	545	562	584	584
Sponsorship	875	345	175	235	215	250
Advertising	45	75	50	55	42	45
Merchandise and catering	155	368	164	160	205	165
Total receipts	1635	1388	934	1012	1046	1044

Payments						
Rent	150	150	150	150	150	150
Marketing and publicity	40	40	40	40	40	40
Administration and salaries	240	280	240	240	240	240
Players' salaries and bonuses	800	1000	800	800	800	800
Overheads and cost of goods	46	60	46	46	46	46
Maintenance	68	80	68	68	68	68
League fees	40	40	40	40	40	40
Kit and equipment	12	12	12	12	12	12
Total payments	1396	1662	1396	1396	1396	1396
Net cash flow	239	(274)	(462)	(384)	(350)	(352)
Opening balance	705	944	670	208	(176)	(526)
Closing balance	944	670	208	(176)	(526)	(878)

Table 3: Monthly ticket sales November 2002 to April 2003

Nov	Dec	Jan	Feb	Mar	Apr
12432	13616	11912	12800	13400	13400

Table 4:

Rainbow Club Ltd

Summary trading, profit and loss account for the years ending 31 December

	2001		***2002***	
	$m	***$m***	***$m***	***$m***
Ticket sales		6.3		6.7
Advertising and sponsorship		11.3		10.9
Merchandise and catering	2.2		2.6	
less				
Cost of goods sold	0.6	1.6	0.8	1.8
Gross profit		19.2		19.4
less				
Overheads		15.6		16.3
Net profit		3.6		3.1

Summary Balance Sheet as at 31 December:

	2001		***2002***	
	$m	***$m***	***$m***	***$m***
Fixed assets		2.4		3.5
Plus				
Current assets	2.5		2.9	
less				
Current liabilities	1.1		2.3	
Net current assets		1.4		0.6
Total/net assets employed		3.8		4.1
Represented by:				
Share capital		1.2		1.2
Reserves		2.6		2.9
Total Capital Employed		3.8		4.1

RIVEAU YACHTS

Background 1975–1993

Riveau Yachts was started as a partnership in 1975 by Jacques Mortain and Yves Millon. Both partners were well-known sailors in France and Yves had represented his country at the Olympics. They quickly spotted the potential offered by a new material being used for boat building – glass fibre – and decided to produce their own boats from glass fibre. The immediate aim was to build a high volume of the boats to spread the high fixed cost of the design. They borrowed $500 000 and built a 3000 square metres plant capable of building a new boat, which they named the "M765" (the length of the boat being 7.65 metres).

Jacques and Yves used their names prominently in the marketing of the M765. Sales rose quickly and it earned a reputation as a boat that offered very good value for money – a key determinant of demand among the main market segment of 25-45 year olds.

By 1985 the growth of yachting as a sport and the higher income levels throughout Europe had helped to push the annual sales to $15 million and assured them of their place as the premier European yacht manufacturer. In December 1985, they decided to convert the partnership into a private limited company and to make their roles clearer. Jacques became the chairman of the company with special responsibility for development and strategy. Yves became the chief executive officer (CEO) with responsibility for management of the plant and the day-to-day operation of it.

By 1993 they had extended the size of the plant to 9 000 square metres and were producing two new models – the J800 and the X1025.

Product Development

In 1994 Jacques and Yves commissioned a report from a prominent firm of management consultants to look at future options for the development of the firm. The consultants identified a number of weaknesses in the company's position including:

- excessive reliance on a small product range
- a large proportion of sales in France (though increasing to other countries in Europe)
- a high level of product-orientation.

The consultants suggested that Jacques and Yves should look more closely at the needs of their customers and develop a more market-oriented approach. They argued that the market for yachts was set to grow considerably as a result of high levels of economic growth in Europe. The investment taking place in sailing and leisure facilities around Europe would contribute further to this growth.

Jacques and Yves were determined to be at the forefront of these developments and in 1995 they raised an extra $7.25 million in loan capital and used this to increase the factory size by 16 000 square metres. They commissioned a new and highly innovative design. This design filled a gap between their existing two yachts the (1800 and the XI025). The new boat was called the D950 (9.5 metres).

In an effort to earn higher margins on each boat and ensure a broad product portfolio, Jacques and Yves began the development of further new products in 1996. These were to be targeted

at higher socio-economic groups and offered more options for tailoring the boats to individual customers' needs. In 2001 they introduced a premium product – the S1200 (12 metre yacht).

The full *Riveau Yachts* product range in 2003 is given in ***Appendix 1.***

Marketing Strategy

Jacques's son André has a marketing degree and six years' experience in the marketing department of a multinational firm selling high-volume consumer goods. He has always been convinced that many of the techniques used to create brand image in consumer goods can be applied to the marketing of yachts.

Since moving to *Riveau Yachts* in 1995 as the marketing director, André has started to develop a marketing approach that focuses on building the reputation of the *Riveau Yachts* brand as a high quality, but still price competitive product. A high proportion of sales are repeat sales where owners upgrade to a larger model. Recommendations from existing customers remain one of their most powerful marketing tools and these recommendations are often used in their advertising in yachting magazines. André has been careful throughout to ensure that the level of after-sales service is high as even the smallest customer complaint can be exaggerated out of all proportion in the eyes of customers.

Much of the selling and after-sales service for the yachts is carried out by a team of 40 appointed dealers throughout Europe. *Riveau Yachts* also have two dealers in the United States and have recently opened three new dealerships in the Baltic States to take advantage of the emerging market opportunities offered as economic growth there increases. In 2003, 75% of their sales were to countries in the European Union, 10% to the United States and 15% to the Baltic States. To ensure consistent standards across all the dealerships, André has produced a set of guidelines laying down best practice in distribution and after-sales service.

André is aware that the demand for the *Riveau Yachts* brand is sensitive to price changes as there is strong competition in the market. The demand for yachts is also income elastic and so André studies economic forecasts concentrating on the levels of economic growth and inflation in their key markets. Inflation and growth figures for the European Union are given in ***Appendix 4***. The price sensitivity of the market means that André liaises closely with the production director to ensure that there are constant improvements in productivity to keep the price as competitive as possible.

Despite the many improvements in the marketing of *Riveau Yachts*, André is now concerned that the rate of growth of sales is starting to decline. He is therefore keen to develop new markets in the Americas and Asia. Asia in particular is a market that he feels is about to enter a period of significant growth. He is also arguing the case for developing new differentiated models of their boats specifically for the charter holiday market, which requires low specification price competitive yachts produced in high volumes. Though their boats have always been reasonably popular with firms operating in the charter holiday market, sales to these firms have suddenly started to fall significantly.

André's proposals for growth are creating tension as Jacques and Yves both feel that further expansion is risky and will have a high level of cost associated with it. In particular, Yves is worried that the uncertainty resulting from exchange rate movements will make it difficult for *Riveau Yachts* to remain price-competitive and that recovery in Asia is still far from

widespread. André, however, believes that the expansion costs are one-off costs and that economies of scale in production will reduce overall unit cost. He has also suggested the possibility of outsourcing production of *Riveau Yachts* to suitable firms in the Americas and Asia, arguing that this would be a relatively low risk method of expansion into these markets. Jacques and Yves are clearly concerned about the loss of control that results from this option.

In November 2003 André commissioned *Future Strat* (a marketing consultancy) to look into different expansion possibilities. They argued that *Riveau Yachts* needed to develop a clearer strategy for growth. This would mean considering the following approaches:

- focusing on existing markets
- new product development for existing customers
- selling existing products to new markets
- diversification into other markets and products.

Human Resource Management

The human resource manager at *Riveau Yachts*, Danielle Jarman, is becoming concerned about staffing at the firm. Though labour turnover has in the past been very low, she has noticed that it is starting to rise. They are also having increasing difficulty recruiting the skilled staff they require. Many of the production workers have been with the firm a long time and consequently the average age of the workforce has been increasing for many years. She also wonders whether the location of the firm may be causing recruitment problems. Many of the younger people from the surrounding villages are moving away to the nearby towns for work. This is making recruitment increasingly time-consuming and therefore expensive. Staffing levels over the last 10 years are given in ***Appendix 5***. She feels that a clearer career progression and more involvement in the decision-making process for workers is needed to maintain their motivation. She knows, however, that it will be very difficult for Jacques and Yves to accept these changes as their style of leadership is very autocratic.

Production

Annette Manning has an engineering degree and five years' experience working for a large computer manufacturer. In 1999 she was commissioned by Danielle Jarman to carry out a full review of the production department at *Riveau Yachts.* The board of directors were very impressed with this review and in 2001 she was appointed as production director of the firm.

Production at *Riveau Yachts* has changed considerably in the time that Annette has been responsible for it. She has standardized many elements of production and progressively made the process more capital intensive. Details of the factory size are given in ***Appendix 6.***

Careful design and the addition of new computer-controlled machinery for cutting and painting of many of the components required in the production process means that Annette has managed to reduce the number of workers required for some stages of production. However, much of the production process remains very labour intensive. Production is organized as an assembly line with the completed hulls being moved around the factory for each stage of production. Workers are organized into specialist groups and each group has a very specific role in the production process. This specialization was one of the key driving forces behind the growth of the firm in the 1980s and 1990s. Each group is quite small and has a team leader who reports to the production supervisor for each stage of production. This means that

there is a low span of control and a tall hierarchy, but Jacques and Yves have always maintained that this is vital to ensure quality.

However, Annette has a number of concerns about this system and has been proposing changes to it. She feels that if they are to maintain their reputation for quality they should move to a more team-based and flexible approach to production where the teams follow the boat around carrying out the relevant tasks at each stage. This would require some retraining of the workforce, but would ensure that they took individual responsibility for large proportions of each boat. This would help improve their motivation and should result in further increases in productivity. Danielle supports Annette's arguments for the shift to team-based production and she feels that the changes would be complementary to her strategies for improving worker motivation. Most important of all, Annette argues, will be the fact that *Riveau Yachts* will then be far more able to personalize the yachts to the customer's specification. This is something that customers are increasingly demanding and many of their competitors are already offering.

Stock control

The continuity of production is assured by keeping high levels of stock. Stock control is not computerized, but is carried out by daily or weekly checking of the stock levels in each area and the matching of these levels with purchase records. Stock is reordered once the average stock level is reached. This has always worked well as there tend not to be large short-term fluctuations in the demand for parts for production.

Financial Situation

The rapid expansion of the firm in the 1980s and 1990s slowed down considerably at the start of this century. Profit and loss accounts and balance sheets for the firm since 1993 are given in ***Appendix 2*** and ***Appendix 3***. The financial director of *Riveau Yachts* has some concerns about the recent changes in the financial position of the firm, though some improvement has been evident in the last two years. They are planning to introduce tighter financial control and cost allocation. However, *Riveau Yachts* does not have specific cost and profit centres and this is affecting their ability to monitor their cost base. The financial director is also concerned about the ability of the firm to meet the high development costs that are associated with new models. If the firm is to keep up with the changing tastes of consumers and the trend towards larger yachts they will need to develop new products, and will require access to further sources of finance. They are therefore considering conversion to a public limited company.

The introduction of the Euro in 2002 created some significant costs for the firm in changing over its financial systems. However, they are now finding it much easier to manage their trade throughout Europe. The financial director is also concerned about the possibility of environmental legislation being introduced in all European countries. Recent legislation places responsibility for the recycling of cars at the end of their life onto the car manufacturers and there has been some suggestion that the same should be the case for yachts. This could raise the production costs of the yachts significantly.

Appendix 1

Current Product Portfolio of *Riveau Yachts*

Model	Length	Year of	Market	Market growth	Comment

		introduction	share		
J800	8 metres	1988	19%	The market for boats of this size is shrinking at around 2% per year and there is a lot of competition with a very significant choice of yachts available.	The J800 is an old design that has a very devoted following, but sales have been gradually falling over the years.
Z850	8.5 metres	1997	32%	This market is a small one and is growing very slowly at around 4% per year, but the Z850 has a very dominant position in the market.	The Z850 is a very innovative design with a number of unique features. It appeals most to the younger segment of the market.
D950	9.5 metres	1995	22%	Market growth for yachts of this size is around 6% per year.	The D950 still sells extremely well but has already been upgraded twice and is starting to show its age against equivalent competitor yachts.
X1025	10.25 metres	1991	18%	Market growth for yachts of this size is around 12% per year.	The X1025 has faced a lot of competition and though sales have grown, the growth has been slow compared to that of the market overall. The X1025 appeals particularly to those upgrading from smaller yachts.
S1200B S1200L	12 metres	2001	26%	The fastest growing sector of the yacht market is the larger boats and the S 1200 has already established itself with a significant market share. Market growth is around 17.5% per year.	The S 1200 is available in two versions – a more basic one (B) and a luxury version (L) with many options for personalization by the owner. The boat appeals mainly to those in their mid-40s and above.

Appendix 2

Profit and Loss Account

	1993 **$**	**2001** **$**	**2003** **$**
Total sales revenue	36 794 175	109 703 500	156 777 550
Cost of goods sold	28 774 250	94 782 000	132 542 000
Gross profit	8 019 925	14 921 500	24 235 550
Marketing, sales and admin expenses	2 775 450	8 746 000	10 758 000
Net profit	5 244 475	6 175 500	13 477 550
Interest payable	675 000	2 254 000	2 856 000

Profit before tax	4 569 475	3 921 500	10 621 550
Corporate tax	1 650 000	978 500	2 574 000
Profit after tax	2 919 475	2 943 000	8 047 550
Dividends per share	0.55	0.60	0.85
Dividends paid	825 000	1 500 000	2 125 000
Retained profit	2 094 475	1 443 000	5 922 550

Appendix 3

Balance Sheet

		1993 $		**2001** $		**2003** $
Fixed assets		6 550 000		35 585 000		42 589 000
			Current assets			
Stocks	4 780 000		21 586 000		26542000	
Debtors	3 520 000		15 652 000		17524000	
Cash	2 565 000		3 456 000		4578000	
Total		10 865 000		40 694 000		48 644 000
Current liabilities		(5 915 000)		(21 138 550)		(17 286 000)
Net assets		11 500 000		55 140 450		73 947 000
			Shareholder funds			
Share capital		2 250 000		4 750 000		4 750 000
Retained profit		3 750 000		17 965 450		25 547 000
Loan capital		5 500 000		32 425 000		43 650 000
Capital employed		11 500 000		55 140 450		73 947 000

Appendix 4

External Factors
Figures – average for EU 15 Countries – Adapted from Eurostat

	1993	**1995**	**1997**	**1999**	**2001**	**2003**
GDP growth – real (%)	1.6	2.5	2.6	2.6	1.7	2.9
Inflation (%)	3.8	3.0	1.9	1.5	2.4	1.8

Appendix 5

Staffing Levels	1993	1999	2001	2003
Management and administration	12	30	38	42
Marketing	7	24	26	21
Production	315	602	570	535

Appendix 6

Factory size (square metres)

1993	1995	2001	2003
9000	25 000	25 000	25 000

GADGETS2U.COM

Beginnings

Gadgets2u.com was started in 2000 by Tom Figueredo. Tom graduated in 1995 from Barcelona University in computer science and worked as a computer programmer and web designer for five years. The rapid development of the world wide web meant that he was very busy and he worked on a number of major dot com start-ups[1]. However, Tom always found working for other firms frustrating and in 2000 he decided to establish his own firm. He saw the potential in the emerging e-commerce[2] industry and felt that there was a possible niche in selling products which use the latest technologies direct to consumers in Spain and elsewhere in Europe.

The firm was established as a private limited company with an initial share capital of €125 000. €25 000 was raised from a venture capital firm Four H. This gave them 20% ownership. Tom put in €30 000 of his own money and on the basis of the business plan borrowed a further €26 250 from the bank. This gave him 45% ownership. The remainder of the initial capital came from Tom's brother Sam who owned 35% of the capital. Tom started on his own, working from home, with a fairly narrow product range.

The concept was very successful and, despite the failure of many dot com companies, *Gadgets2u.com* went from strength to strength. This high growth rate meant that in 2001 Tom employed further staff and moved, in 2002, to a purpose-built office space on the outskirts of Seville. Rapid growth continued and by the end of 2004 the firm employed a total of 16 staff including Tom, six of whom had been fellow computer science students with Tom at Barcelona University. All new employees were offered shares in the firm as an incentive to motivate staff. Five of the 16 staff worked from home – up to 150 km from the *Gadgets2u.com* office.

Organizational structure

To ensure his vision for the business, Tom has always been determined that all employees share responsibility for the development of the firm. The business is organized as a matrix structure with a number of project teams. There is a project team for each major business function and other project teams are set up as required. As a result, the organizational structure is flat. When required, experts are hired to give specialist advice to project teams. A recent addition this year (2005) is a development project team to consider the future direction of the firm. Each project team has a project leader who takes overall responsibility, but Tom is keen to spread these roles and rotate them to ensure that everyone stays closely involved and highly motivated.

[1] dot com start-up: is a new Internet-based firm that sells the majority of its products through a web site.
[2] e-commerce: is the process of selling goods and services to consumers through the Internet. Transactions are processed through the company web site.

The project leaders report to the senior management team – Tom, his brother Sam and a representative from the venture capital firm. There is no formal communication between the project teams, but special days are organized every two months when everyone in the business gets together away from the office to discuss whole firm issues. Communication between the teams is generally informal and most people serve on at least two project teams with roles being frequently rotated. For the first few years this proved to be a very efficient

form of communication and helped with the rapid growth of the firm. However, continued expansion has led to some recent problems with communication between project teams and many staff find they are under increasing time pressure. For example, a recent upgrade of the e-commerce system resulted in a two-week delay to distribution. The web site team failed to consult with the distribution team over the timing of the upgrade and some customer details were lost in the process. This caused large numbers of customer complaints and took nearly a month to sort out. Some of the longer-serving staff are commenting that the special days now seem to focus on day-to-day tactical decision making and do not spend enough time on strategy and development. As a consequence of these problems the team leader for human resource management (Juan Alvarez) is keen to reduce the span of control and make the hierarchy taller to improve efficiency.

The accounting function is sub-contracted to a specialist firm which prepares regular monthly management accounts for the senior management team. All company information is held centrally and accessible to all employees through the company Intranet. Nothing is kept confidential and there are no restrictions on accessing the information.

Marketing

The company's product range includes the latest mobile phones and accessories, digital cameras and a range of other innovative products. All the products are technologically advanced and at the early stage of their life cycle. The firm's target market is mainly young males (age 25-35) of higher socio-economic groups who are classified as "early adopters" or "innovators". Tom believes that price is less important to this group than the nature of the product itself and so *Gadgets2u.com* has adopted a price-skimming strategy for most of their product range. The marketing team have noticed that they are developing a core group of customers who purchase frequently from the site.

Demand for the products is seasonal – the peak levels for sales are the two months leading up to Christmas, when the firm earns nearly 40% of its annual revenue, and June and July. All sales are by credit card through the web site and *Gadgets2u.com* pays a fee to a company that processes the credit card payments. *Gadgets2u.com* receives payment from the credit card company one month after the goods are sold.

Demand for innovative products is sensitive to changes in income. Tom is concerned that the forecasts for economic growth in the European Union will adversely affect sales ***(Appendix 1)***. From these economic forecasts and past sales growth the sales team has developed sales forecasts for 2005-2007 ***(Appendix 2***).

Gadgets2u.com uses a range of promotional techniques to maintain and develop its brand. Customers receive a monthly e-mail newsletter setting out special offers. Marketing information about all customers is entered on a database. This enables the marketing team to analyse spending patterns and from this information to target customers with additional products related to previous purchases.

Additional market research is done through occasional web-based surveys of their customers. However, there has been a suggestion by one of the marketing team that they need to carry out more detailed market research using more precise sampling techniques. He has also suggested that they look carefully at the demographic structure of their market as an aging population in Europe may change the pattern of demand.

A key marketing objective is to attract potential customers to the web site. They advertise

in a number of major Spanish men's magazines and Tom writes a monthly "Technology" column for one of them.

They also rely on word-of-mouth endorsement from existing customers. 55% of the firm's sales are currently within Spain, 35% to other countries in the European Union and 10% to outside Europe. Sales from outside Spain are growing fast and Tom is keen to build on this success and has instructed the marketing team to develop a strategy to expand international sales.

Purchasing and stock control

Purchasing is a vital function within *Gadgets2u.com*. Tom has been the team leader for this function since the founding of the company. He is reluctant to give up the role as he enjoys the challenge of finding new products and forecasting how successful they will be. However, he can be very autocratic in his decisions about new products and some of the purchasing team feel that their input is not always taken into account. One member of staff recently asked for a transfer to the distribution team.

When the team decides to adopt a new product, they predict how well they think it will sell and order stock on the basis of these sales forecasts. This approach has generally worked well, but sometimes the sales variance has been highly adverse. This has resulted in excess stocks. Tom argues that high stock levels are necessary to meet fluctuating demand. The purchasing team are examining alternative methods such as just-in-time (JIT) stock control to match supply more closely to demand.

The senior management team is examining the firm's purchasing approach and Sam wants to re-focus their product range on fewer products. He feels that this will enable them to negotiate better deals and increase their margins. However, Tom opposes this as he feels that the company's success and reputation is built on the breadth of their product range.

Distribution

In August 2003 Tom appointed Miguel Delgado as distribution manager. The appointment caused unrest as other team members, who had more experience but had not been at university with Tom, had been overlooked. Presently the company uses the Spanish postal service and a range of international couriers for delivery of products. Following a number of customer complaints about lost products and slow delivery Miguel is investigating alternative channels of distribution and whether they can get a better price by committing to just one delivery firm.

The rapid growth of the company means that the existing premises are no longer adequate. The stock is now piled all around the office. Senior management have approved the setting up of a separate warehouse to improve stock management. The warehouse will be 3 km from the main office building. The firm has rented the warehouse with effect from December 2005, but the building needs some work and it is estimated that *Gadgets2u.com* will be able to start using it from April 2006.

The new warehouse will expand the potential sales capacity of *Gadgets2u.com* and will help to lower costs as the firm takes advantage of economies of scale. It will allow more efficient distribution and this should help increase customer satisfaction which has suffered in recent months. However, it is likely that there will be spare capacity in the first year which will

increase unit costs temporarily.

Suzi Garcia, the company accountant, has suggested to Tom that they run the new warehouse as a separate cost centre. Tom has rejected the proposal believing this may result in loss of control by the senior management team. However, despite Tom's rejection, Suzi, with the support of the distribution project team (excluding Miguel), has prepared a report recommending the development of the cost centre to the senior management team.

The new warehouse will require a further injection of funds of €35 000 and the senior management team is considering various options for raising this finance. The venture capital firm Four H is prepared to provide this finance, but they want to take a higher proportion of the shares in exchange.

Human resource management

The team leader for human resource management, Juan Alvarez, is an old friend of Tom's. He joined the company in 2004 and immediately introduced a training programme for all staff. He realizes that with the growth of the company there needs to be a formal training programme. Up to now, recruitment has been sub-contracted to several specialist employment agencies. However, Juan is keen to take responsibility for future recruitment. He has also suggested introducing an appraisal system. Tom is happy to agree with this, but insists that he is involved with all appraisals.

Tom is also questioning whether the five staff who work from home should continue to do so or whether they should be encouraged to move into the office. Juan is not keen on this change as he believes that working from home helps to motivate staff.

Finance *(Appendices 3, 4 and 5)*

Gadgets2u.com has now been profitable for three years. This is partly due to rapid sales growth, but also careful cost control. However, despite the successes, there are some worries. Short-term borrowing has risen fast and Suzi is concerned about the current financial situation. The cash flow statement in ***Appendix 5*** shows clearly the cash flow difficulties the firm faces because of the seasonal nature of demand.

Another financial issue is the impact of exchange rates. *Gadgets2u.com* buys most of its stock from firms in the US and Japan and therefore a large proportion of its expenses are incurred in Dollars and Yen. However, most of its sales are in the European Union and a large proportion of its revenue is therefore earned in Euros. Recent exchange rate fluctuations have resulted in variable profit margins and the senior management team is considering ways to reduce exchange rate risk. Forecast exchange rates for 2005, 2006 and 2007 are given in ***Appendix 1***.

Future development

The senior management team is delighted that *Gadgets2u.com* has achieved more than expected in the original business plan. However, differences are starting to emerge regarding the future direction of the firm. Tom is keen to continue offering new products to existing core customers, but Sam thinks that they should aim to develop the brand by diversifying. Sam is proposing to the senior management team an expansion into retail operations for the firm. He believes that franchising the brand for retail stores will enable

them to expand rapidly creating greater brand exposure. He argues that this should be combined with careful international marketing to broaden the sales base of the firm.

Miguel has discovered that one of their key suppliers has been attracting media attention as their phones give out a higher level of radio emissions than are allowed under European Union regulations. They have been selling these phones at low prices in countries where the regulations are not as tight. The supplier has also been accused by the media of not meeting basic health and safety requirements in the factories in developing countries. There is considerable disagreement within the company about whether they should continue using this supplier.

Appendix 1

Economic forecasts

	2004	2005 (forecast)	2006 (forecast)	2007 (forecast)
European Union inflation (%)	0.7	1.2	1.4	2.7
European Union growth (%)	2.2	1.4	1.9	3.1
Exchange rate–yen per euro	140	153	160	146
Exchange rate–dollars per euro	1.16	1.26	1.3	1.2

Appendix 2

Sales performance and forecasts (Euros)

Sales	2001	2002	2003	2004	2005 (forecast)	2006 (forecast)	2007 (forecast)	2008 (forecast)
Sales level (€)	80 000	450 000	1 260 000	2 640 000	3 790 000	4 360 000	4 580 000	5 030 000
Change in sales (%)		463	180	110	44	15	5	10

Appendix 3

Balance sheet as at 31 December (Euros)		**2003**		**2004**
Fixed assets		120 000		187 500
Current assets				
Stocks	117 500		322 750	
Debtors	97 500		179 500	
Cash	13 500		11 500	
Total		228 500		513 750
Less Current liabilities		(187 500)		(203 050)
Net assets		161 000		498 200
Shareholder funds				
Share capital		200 000		200 000
Profit and loss account		(485 500)		(248 300)

Loan capital	446 500	546 500
Capital employed	161 000	498 200

Appendix 4

Profit and loss account for the year ended 31 December (Euros)	**2003**	**2004**
Sales revenue	1 260 000	2 640 000
Cost of goods sold	870 000	1 720 000
Gross profit	390 000	920 000
Overheads	327 500	560 000
Net profit	62 500	360 000
Interest payable	52 400	63 500
Profit before tax	10 100	296 500
Corporate taxation	2 020	59 300
Profit after tax	8 080	237 200

Appendix 5

Cash flow statement October–December 2004

(Euros)	**October**	**November**	**December**
Receipts			
Sales	225 000	390 000	575 000
Total receipts	225 000	390 000	575 000
Payments			
Interest	5 292	5 292	5 292
Purchases	385 000	296 000	69 000
Salaries	32 000	32 000	32 000
Rent	2 250	2 250	2 250
Office expenses	3 200	2 750	3 450
Distribution costs	3 620	6 250	9 650
Other overheads	2 568	2 648	2 758
Total payments	433 930	347 190	124 400
Net cash flow	(208 930)	42 810	450 600
Opening balance	(272 980)	(481 910)	(439 100)
Closing balance	(481 910)	(439 100)	11 500